***The Wall Street Journal***

[WORLD NEWS](http://www.wsj.com/news/types/world-news) **Calls Grow for a New Microloans Model**

New scholarly research showing that tiny loans to poor entrepreneurs fail to raise incomes prompts fresh debate



A local leader counts money to be distributed as microloans to women who are raising cows or opening village tea stalls in Sadasivpet, India. *PHOTO: BLOOMBERG NEWS*

By  **ERIC BELLMAN**

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Some of the world’s top experts in microlending recently gathered to debate a hot topic: Has the microloan boom of the last decade actually helped global efforts to lift people out of poverty?

The event was prompted by the latest issue of the prestigious American Economic Journal: Applied Economics, which published a group of independent studies suggesting that microlending—tiny loans to poor entrepreneurs—usually fails to raise incomes.

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While the broader debate has raged for years, the report—which combined randomized control trials in six countries backed by scholars at prestigious international universities—prompted a new round of soul-searching in the sector.

“This is kind of a defining moment,” Abhijit Banerjee, an economics professor at the Massachusetts Institute of Technology who co-wrote one of the studies, said during the debate, at a World Bank conference in February. “The big question that we would like to answer is what is the right product [for the poor] to have? What is missing?”

Many disagree with the studies’ conclusions, saying the industry has helped lift millions from poverty.

Vikram Akula, the founder of one of India’s largest microlenders, SKS Microfinance Ltd., said he has witnessed the benefits of microlending in villages across India. But Mr. Akula, who left SKS in 2011, said that newly critical scholarly studies are changing the way donors look at projects and how lenders measure success.

“The theme of financial inclusion does not have the same shine as it once had and this kind of study certainly contributes to that,” said Mr. Akula, who recently launched a new, for-profit financing firm which targets people without bank accounts. “It is part of a broader narrative that microfinance isn’t a panacea, which we all knew.”

More than two-billion adults worldwide don't have bank accounts. Financial inclusion, or the delivery of mainstream financial services at affordable costs, is a step towards fixing this.

The microfinancing model was first tried on a large scale by Muhammad Yunus’s Grameen Bank of Bangladesh. Mr. Yunus and the bank were jointly awarded the Nobel Peace Prize in recognition of the transformative power of tiny loans which have reached millions of impoverished people.

Part of the allure of microlending—at least for charities, philanthropists, organizations and volunteers—is its simplicity. The loans help the poor create businesses and raise their incomes, allowing them to repay the loan money, which is then recycled to help other poor people. The business can expand rapidly and is largely self sufficient.

Millions of people have been provided microloans over the years, part of a global network that has efficiently and usually profitably reached the hardest-to-reach corners of the globe.

However, some studies suggest the business model has fallen short in providing the kind of transformation and financial inclusion many had once expected. That is what the American Economic Journal tried to examine more closely. The publication tallied six studies which each independently tried to measure how the lives of microloan recipients had changed in countries as diverse as Mexico, Mongolia and India between 2003 and 2012.

The reports’ results surprised many people involved in the microlending business. Although microloans did give borrowers better access to credit, which they used for their small businesses, the studies found they tended not to result in higher incomes or consumption. Nor did they find much evidence of any big social dividend such as more empowered women or better educations for children. One study even cited evidence that the microloans might have encouraged families to remove children from school to work.

The American Economic Journal was the first scholarly publication to join the independently produced studies.

“Bringing these together really has shifted the conversation,” said Timothy Ogden, managing director of the Financial Access Initiative, a New York University research center. “There are a lot of people that were unaware” that microfinance fails to lift many people out of poverty.

However, at the World Bank conference and elsewhere skepticism of the studies is rife. Critics question the methodologies and wonder whether the reports are focused on unusually ineffective microlenders. These people say the borrowers’ willingness to pay the typically more than 25% lending rates for the loans show they get good value from the service. They also suggest it may be too early to judge. And they cite their first-hand observations that many lives have been transformed.

Defenders of the microlending model said it was never expected to quickly end poverty, but rather, to give more choices to impoverished people who had been largely ignored by banks and other lenders.

“I presume we can all also agree that microcredit has not cured cancer, nor the common cold,” said Alex Counts, president and chief executive of the Grameen Foundation, an international arm of Grameen Bank. “But why use unrealistic standards to frame the discussion?”

Mr. Counts said even the most negative researchers’ reports show that up to 10% of microborrowers experience a big jump in income and the rest aren’t harmed. While he suspects other microfinance programs—particularly those in Bangladesh which weren’t surveyed—would show a higher success rate, the latest reports can be “a call to action for researchers, practitioners and policy-makers to roll up their sleeves and work collaboratively to develop successive waves of better credit products for the poor.”

Like Mr. Counts, most agree the sector needs to innovate and evolve to better serve the poor and produce easier-to-measure benefits.

The discussion varies from the need for microlenders to offer more savings and insurance options for the poor to the need for them to include more business training, healthcare and education with their loans. Some advocate for more flexibility in the types of loans or a greater focus on borrowers who are using the loans to lift their incomes.

A danger, according to people involved in the microlending sector, is that if the industry doesn’t find ways to improve its business model and the benefits, it could lose money from lenders, socially conscious investors and support from charitable groups. It also risks losing the army of committed and passionate workers who believe they are helping to solve one of the world’s worst problems, poverty.

“They will definitely have to tweak the model,” Dr. Banerjee said. “The drama of the narrative is really attractive to people. It is going to be harder to attract people if that narrative is not there.”



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